



# EERC Policy Brief

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## Elections and the quality of regional government in Russia

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### The benefits of elections

The relations of a ruler with the public are somewhat similar to those of an employee with a disorganized employer – the public has no way to write a formal contract contingent on the ruler's performance, and cannot decide whether to replace such an "employee" at any point in time. Thus, the ruler can abuse (absolute) power and (absolutely) disregard the interests of her employer, the public.

Elections, the main formal attribute of a democratic society, partially solve the problem. In case of fair elections, voters may choose the candidate whom they expect to deliver the highest benefit to them. Thus, elections work as a selection device that allows to filter out the less attractive (incompetent and non-benevolent) candidates. Incumbent politicians understand that their current performance will be treated by the public as a measure of their future performance. This creates incentives for the rulers to work for the sake of their society, even though there is no direct or immediate reward/punishment mechanism in place.

### The costs of elections and political business cycles

The costs of elections include not only direct costs, such as the cost of holding elections and spending on electoral campaigns. Elections also create the incentives for populist policies on the eve of elections – incumbents may want to run fiscal expansion to improve the public's expectations about their ability and benevolence. Such expansion usually takes the form of increased social transfers, since their recipients are poor people who constitute a significant part of politically active population, and who are quite sensitive to transfers. The post-election period is often characterized by a fiscal contraction, borrowing or tax increases to finance or offset the effect of the pre-election expansion. The term "political business cycle" (PBC) stands for such up and down dynamics around the time of elections. The cost of PBC can be approximated by the volume of resources that have to be generated (through increased borrowing or taxation) to cover deviations from a steady policy.

### Political business cycles in Russia's regions

A recent study by Akhmedov and Zhuravskaya which used data on gubernatorial elections has provided statistical evidence for the existence of PBC in Russia's regions. It shows that the cycles are very short (the main changes take place one or two months around the elections), but quite significant – budgetary spending grows by 9% in the pre-election months and falls immediately after the elections. While such a cyclical nature is characteristic of most budgetary items, the cycle is driven by social transfers, which grow by as much as 18% in the pre-election month.

### The end of a decade-long experiment with gubernatorial elections

Gubernatorial elections have been first instituted in Russia's regions in 1991. Under President Yeltsin, regional governors enjoyed strong bargaining position vis-à-vis the federal center and about one half of them belonged to the opposition. The situation has changed dramatically in Putin's times.

In 2004, the majority of governors turned to support the federal power in exchange for assurances that the latter will not meddle in regional politics. Governors that remained in opposition either faced tough competition with federal candidates that had serious political and financial backing, or were simply not allowed to run for office. The most serious punishment to loyal governors suspected in corruption was promotion to ministerial positions in the federal government.

In September of 2004, right after the terrorist raid on Beslan, President Putin moved to abolish gubernatorial elections and give himself the authority to appoint and dismiss governors. Formally, the President's candidate has to be approved by a local Duma, but so far this has been a mere formality: to date, all presidential appointees (38) have been approved. In at least one case a local Duma approved an absolutely unknown candidate.

The basic rationale provided by the Kremlin for this move was: 1) centralization of power will help fight terrorism;

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2) governors are captured by interest groups and do not serve public interests; 3) elections are captured by the local authorities and do not reflect public preferences while wasting a lot of resources on pre-election warfare. With such an explanation in mind, one could expect an increased turnover of corrupt or incompetent governors. However, about 4/5 among presidential appointees have been incumbents, as compared to a 2/3 election success rate of incumbent governors. The list of dismissed governors includes not only failed governors, whose reappointment could have created massive protests in the regions, but also quite popular, but unsuitable governors. For example, Vasilii Starodubtsev, a former GKChP member, who twice won in the first round of regional elections with 63% and 71% of votes in 1997 and in 2001, was not appointed when his term expired.

### **The notion of Political Business Cycle revisited: not all bad news**

One could argue that incumbent rulers run political business cycles and win elections because of voters' myopia. There are, however, alternative explanations for the presence of PBC, which are based on rational behavior of voters. For example, according to opportunistic theory of PBC, incumbents increase budget expenditures to demonstrate (to signal about) their competence and benevolence to the public. According to this theory, only the better incumbents do so. Yet another theoretic explanation links cyclical changes in fiscal policy to policymakers' experience. Suppose that a ruler's performance depends not only on her talent and care for social welfare, but also on her experience of managing the region. In this case one could expect that performance (and fiscal policy) improves over time, being *on average* higher just before and lower just after the elections. Formal statistical tests, not accounting for the effect of experience, would provide support for the presence of PBC. However, one would not be able to conclude based on this evidence that PBC is driven by purely opportunistic motives.

The experience factor has important behavioral implications for both voters and incumbent politicians. The rulers' exclusive ability to work in the "relevant" office and thus acquire the "relevant" skills implies that an incumbent can be rationally preferred by the public even to a more talented challenger. To the extent that voters exhibit such an "incumbency bias", experienced rulers can expect to be re-elected whether they capture the process of elections or not.

It is worth noting that in reality skills are acquired not automatically by sitting in the office, but rather through

hard work. Thus, a governor facing a talented challenger could still win the election by making a sufficiently high investment in own ability. In other words, the threat of electoral competition may lead to better performance in office, even without a proper contract that links tenure to performance.

Empirical studies show that PBC in Russia's regions have been driven by both experience and opportunistic fiscal expansion. The input of experience, however, is much smaller than that of opportunism: one term of experience increases budget spending by only 2%, and social expenditures by 4%, which is almost ten times less than then the increase of these indicators in the pre-election quarter. Even though our data show that the positive effect of experience is not as strong it is good news that it exists. In contrast, it remains unclear what will drive governors' incentives under the appointment system.

### **Abolishing gubernatorial elections: benefits**

According to the new law, the President is now effectively deciding on who will be the governor in each region. This may be a fine arrangement to extent that the President is better informed about gubernatorial performance and is better educated than a representative voter in each region. Importantly, the President is a much less "disorganized employer" than the public at large and can reconsider employment of regional rulers at any time, thus reducing the scope for power abuse. Of course, these advantages are contingent on the President's benevolence and personal capacity to make the right choices.

Finally, the abolishment of elections removes all costs associated with elections, both direct and indirect.

### **... and costs**

The mechanism of direct presidential appointment of governors has also a number of costs attached. First, the President may face a conflict of interest in deciding whom to appoint: considerations of personal and political loyalty may contradict considerations of regional prosperity. Thus, more talented and popular governors who are more likely to have independent political views may be less likely to be appointed.

Surely, the president of a federation cannot credibly commit to protecting the interests of a particular region (at the expense of other regions and the federation). This is likely to create wrong incentives for regional governors: they will tend to serve the interests of the President – their effective employer – rather than those of the public.

The Economics Education and Research Consortium, Russia and CIS (EERC) is a non-governmental non-profit charity foundation. Its main purpose is to strengthen economics education and research capabilities in the CIS. The initial focus of EERC was on graduate level education (in Ukraine, <http://www.eerc.kiev.ua>) and research (in Russia, <http://www.eerc.ru>).

EERC's mission is to create and to support a local research culture, to encourage individual economists to work at the frontiers of their discipline, and to subject research to international standards of excellence. The final goal of our activities is to bridge the gap between the academic research (and researchers) and the policymaking process in CIS countries. EERC activities in Russia and the CIS are geared towards strengthening the local capacity for economics research and policy analysis. Programmatic activities include competitive grantmaking, training, organization of policy-focused meetings and conferences, and facilitation of international research projects.